

GAO

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FINANCIAL AUDIT

Federal Home Loan Bank Board's 1986 and 1985 Financial Statements



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**United States
General Accounting Office
Washington, D.C. 20548**

**Comptroller General
of the United States**

B-114893

June 9, 1987

To the President of the Senate and the
Speaker of the House of Representatives

This report presents our unqualified opinion on the Federal Home Loan Bank Board's financial statements for the years ended December 31, 1986 and 1985, and our reports on the Bank Board's system of internal accounting controls and on its compliance with laws and regulations.

The Federal Home Loan Bank Board is an independent agency in the executive branch that formulates policies for and supervises the operations of the 12 Federal Home Loan Banks, the Federal Savings and Loan Insurance Corporation, and the system of federal savings and loan associations. The Bank Board is directly related to and, in many respects, is a part of the Federal Savings and Loan Insurance Corporation structure. We are also issuing our qualified opinion (GAO/AFMD-87-41) on the Corporation, which had losses of almost \$11 billion in 1986 and whose ability to fulfill its mission is dependent upon obtaining additional funding.

Our report on compliance with laws and regulations discloses that the Bank Board improperly accepted payments and reimbursements for travel-related expenditures. The Bank Board has since amended its policies to forbid acceptance of such payments and reimbursements.

In July 1985, the Bank Board delegated its responsibility for examining savings and loan associations and the related staff who perform this function to the 12 Federal Home Loan Banks. This transfer resulted in a significant reduction in income and expenses and related assets and liabilities on the Bank Board's 1986 and 1985 financial statements.

The Bank Board, under 12 U.S.C. 1438(c)(6), is subject to the audit provisions applicable to wholly owned government corporations, 31 U.S.C. 9105, under which the Comptroller General audits the financial transactions of such corporations. We conducted our examinations in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Chairman of the Federal Home Loan Bank Board.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

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**Comptroller General
of the United States****B-114893**

To the Chairman
Federal Home Loan Bank Board

We have examined the statements of financial condition of the Federal Home Loan Bank Board as of December 31, 1986 and 1985, and the related statements of income and expenses and retained earnings, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in note 2 to the financial statements, on March 14, 1985, the Bank Board delegated the function of field examinations of insured savings and loan associations to the 12 Federal Home Loan Banks. Effective July 6, 1985, all field examination functions and Bank Board personnel previously assigned to and under the direction of the Bank Board's Office of Examinations and Supervision were transferred to the 12 banks. This transfer resulted in a significant reduction of income and expenses and of the related receivables and liabilities on the Bank Board's 1986 and 1985 financial statements. After July 6, 1985, the Bank Board no longer had income earned from examining savings and loan associations or the related compensation, benefits, and travel expenses associated with the Bank Board employees performing those examinations. In addition to the effect on the income statements, the Bank Board no longer accrues accounts receivable for examination fees or accounts payable for examiners' payroll and annual leave.

In our opinion, the financial statements referred to above present fairly the financial position of the Federal Home Loan Bank Board as of December 31, 1986 and 1985, and the results of its operations and changes in financial position for the years then ended, in conformity

with generally accepted accounting principles applied on a consistent basis.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

April 17, 1987

Report on Internal Accounting Controls

We have examined the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1986 and 1985, and have issued our opinion thereon. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended December 31, 1986. (Our report on the study and evaluation of internal accounting controls for the year ended December 31, 1985, is presented in GAO/AFMD-86-64, dated July 15, 1986.)

As part of our examination, we made a study and evaluation of the Bank Board's system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank Board's financial statements. For purposes of this report, we have classified the significant internal accounting controls in the following categories:

- expenditure,
- financial reporting,
- revenue, and
- treasury.

Our study and evaluation included all of the control categories listed above except for treasury and financial reporting. For these activities, we found it more efficient to rely solely on substantive audit tests. In addition, we reviewed the Bank Board's report for the year ending September 30, 1986, issued pursuant to section 2 of the Federal Managers' Financial Integrity Act of 1982 to determine the existence and status of any internal control weaknesses relevant to financial matters.

The Bank Board's management is responsible for establishing and maintaining an effective system of internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the Bank Board's assets. Because of inherent limitations in any system of internal

accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the Bank Board's system of internal accounting controls taken as a whole or on the categories of controls identified in the second paragraph. Our study and evaluation did not disclose any internal accounting control weaknesses which we considered to be material in relation to the financial statements taken as a whole.

During the course of our examination we identified several weaknesses in internal accounting controls and procedures that we did not consider material to the financial statements. Nonetheless, they merit corrective action to strengthen the Bank Board's internal accounting controls, and we are reporting them separately to the Bank Board.

Report on Compliance With Laws and Regulations

We have examined the financial statements of the Federal Home Loan Bank Board for the years ended December 31, 1986 and 1985, and have issued our opinion thereon. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of compliance with laws and regulations as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended December 31, 1986. (Our report on the review of compliance with laws and regulations for the year ended December 31, 1985, is presented in GAO/AFMD-86-64, dated July 15, 1986.)

In our opinion, the Bank Board, except for the matter discussed below, complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements.

The Chairman, Subcommittee on HUD-Independent Agencies, House Committee on Appropriations, requested a legal opinion concerning the statutory limitation contained in annual appropriation acts on "administrative expenses" of the Bank Board. Specifically, we were asked whether the Bank Board can accept payments or reimbursements from the Federal Home Loan Banks for administrative expenses without being subject to the statutory limitation. In B-225986, March 2, 1987, we reported that

"neither the Board nor its officers and employees have the legal authority to accept payment or reimbursement from the [Federal Home Loan] Banks for the travel-related administrative expenses of Board personnel. Such expenses must be paid by the Board, using its own funds, which would, of course, be subject to any limitation on the Board's administrative expenses contained in an annual appropriation act."

In 1986, the Bank Board received \$186,000 in such travel-related payments and reimbursements. While these payments and reimbursements were not material to the Bank Board's financial statements, their occurrence nonetheless points out the need for management's attention to compliance with laws and regulations. In December 1986, in response to congressional inquiries into this matter, the Bank Board issued a policy statement specifically forbidding such payments and reimbursements.

In connection with our examination, except for the matter discussed above, nothing came to our attention that caused us to believe that the Bank Board was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

The travel-related expenditure matter explained above was considered in determining the nature, timing, and extent of the audit tests to be applied in our examination, and does not affect our opinion on the Bank Board's financial statements dated April 17, 1987.

Financial Statements

Statement of Financial Condition

FEDERAL HOME LOAN BANK BOARD
COMPARATIVE STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 1986 AND 1985
(in thousands)

	<u>1986</u>	<u>1985</u>
<u>Assets</u>		
Cash with U. S. Treasury.....	\$ 749	\$ 803
Accounts receivable (Note 2).....	8,694	4,899
Land and building (Note 1).....	42,566	45,116
Furniture, fixtures and equipment (Note 1)....	5,873	5,798
Other assets.....	<u>39</u>	<u>345</u>
Total assets.....	57,921 =====	56,961 =====
<u>Liabilities</u>		
Accounts payable and accrued liabilities.....	2,912	3,124
Employees' accrued annual leave.....	<u>1,122</u>	<u>1,437</u>
Total liabilities.....	<u>4,034</u>	<u>4,561</u>
<u>Capital</u>		
Retained earnings.....	12,857	8,306
Paid in capital	<u>41,030</u>	<u>44,094</u>
Total capital (Note 6).....	<u>53,887</u>	<u>52,400</u>
Total liabilities and capital.....	\$ 57,921 =====	\$ 56,961 =====

The accompanying notes are an integral part of these financial statements.

Statement of Income and Expenses and Retained Earnings

FEDERAL HOME LOAN BANK BOARD
 COMPARATIVE STATEMENT OF INCOME AND EXPENSES
 AND RETAINED EARNINGS
 FOR THE YEARS ENDED DECEMBER 31, 1986 and 1985
 (in thousands)

<u>Income</u>	<u>1986</u>	<u>1985</u>
Examination fees from savings and loan institutions (Note 2).....	\$ -0-	\$ 11,717
Assessments:		
Federal Home Loan Banks.....	8,268	10,423
Federal Savings and Loan Insurance Corporation..	24,819	20,960
Savings and loan institutions.....	-0-	10,274
Gain on sale of land (Note 1).....	9,176	-0-
Rent and miscellaneous other.....	<u>1,872</u>	<u>2,022</u>
Total income.....	44,135	55,396
	*****	*****
<u>Expenses</u>		
Personnel compensation.....	15,679	32,057
Personnel benefits (Note 3).....	2,118	3,846
Travel and transportation.....	942	5,242
Rent, communication, and utilities.....	3,245	4,302
Depreciation:		
Furniture, fixtures, and equipment.....	1,085	1,000
Building.....	905	902
Return of gain on sale of land to FHLBanks (Note 1).....	9,176	-0-
Building maintenance and other services.....	<u>6,533</u>	<u>5,937</u>
Total expenses.....	39,683	53,286
	*****	*****
Net income.....	4,452	2,110
Prior year adjustments.....	99	(3,769)
Retained earnings at beginning of year (Note 6).....	8,306	9,965
Retained earnings at end of year (Note 6)	\$ <u>12,857</u>	\$ <u>8,306</u>
	*****	*****

The accompanying notes are an integral part of these financial statements.

Financial Statements

Statement of Changes in Financial Position

FEDERAL HOME LOAN BANK BOARD
 COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITION
 FOR THE YEARS ENDED DECEMBER 31, 1986 AND 1985
 (in thousands)

	<u>1986</u>	<u>1985</u>
<u>Source of Funds</u>		
Net income.....	\$ 4,452	\$ 2,110
Adjustment for non-cash items:		
Depreciation.....	<u>1,990</u>	<u>1,902</u>
Funds provided from operations.....	6,442	4,012
Decrease in:		
Other assets.....	306	(345)
Sale of land (Note 1).....	3,064	-0-
Prior year adjustment to retained earnings (Note 4).....	99	-0-
Total.....	9,911	3,667
Financial resources generated not affecting cash:		
Accounts receivable transferred to FHLBanks (Note 2).....	<u>-0-</u>	<u>3,124</u>
Total funds provided.....	9,911 =====	6,791 =====
<u>Application of Funds</u>		
Acquisition of capital assets	2,579	2,005
Decrease in:		
Accounts payable and accrued liabilities...	212	2,834
Accrued annual leave.....	314	2,141
Increase in:		
Accounts receivable.....	3,796	(3,519)
Refund of construction funds (Note 5)	-0-	490
Reduction of paid-in-capital-sale of land (Note 1).....	<u>3,064</u>	<u>-0-</u>
Total.....	9,965	3,951
Financial resources applied not affecting cash:		
Accounts receivable transferred to FHLBanks (Note 2).....	<u>-0-</u>	<u>3,124</u>
Total funds applied	<u>9,965</u>	<u>7,075</u>
Decrease in cash	\$ (54) =====	\$ (284) =====

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

FEDERAL HOME LOAN BANK BOARD
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 1986 AND 1985

1. Summary of Significant Accounting Policies:

- a. Furniture, Fixtures and Equipment - Cost of Furniture, Fixtures and Equipment at December 31, 1986 and 1985 were \$12,367,816 and \$11,207,107 less accumulated depreciation of \$6,494,574 and \$5,408,994 respectively. Depreciation is computed on the straight-line method based on an 11 year useful life. Beginning on October 1, 1986 all FHLBB FF&E purchases below \$250,000 will be expensed and only those purchases exceeding that limit will be capitalized and depreciated.
- b. Land and Building - These assets are recorded at cost less accumulated depreciation for the building. Cost of land was originally \$10,165,227 and is now at \$7,101,112 because the parcel of land at 3rd and D Streets, N.W. Washington, D.C. was sold in September 1986. The proceeds from the sale (cost \$3,064,115 and gain \$9,175,884) were reimbursed to the 12 FHLBanks since they were originally assessed for the land purchase. Building costs at December 31, 1986 and 1985, were \$43,114,511 and \$41,695,292 less accumulated depreciation of \$7,649,727 and \$6,744,926, respectively. Depreciation for the building is computed on the straight-line method over 50 years.
- c. Reclassifications - Reclassifications have been made in the 1985 Financial Statements to conform to the presentation used in 1986.

- 2. Related Party Transactions - The twelve District Federal Home Loan Banks (FHLBanks), together with their member institutions, comprise the primary components of the FHLBank System. In addition, their affiliated corporations - the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Mortgage Corporation and the Neighborhood Reinvestment Corporation - assist in carrying out the Bank System's mission. The FHLBank System is governed and regulated by the Federal Home Loan Bank Board (Bank Board) which is an independent Federal agency in the executive branch of government. The Bank Board is the chartering and regulatory authority for the federal savings and loan associations and federal mutual savings banks. Further, the Bank Board, through the Federal Savings and Loan Insurance Corporation (FSLIC), governs the insurance of accounts in savings and loan associations and mutual savings banks. Bank Board expenses are met through assessments from the FHLBanks and the FSLIC. This income is recognized as earned monthly.

On March 14, 1985, the Bank Board delegated the responsibility for examining savings and loan institutions to the Federal Home Loan Banks and, at the same time, voted to transfer the entire District Office staff to the 12 Federal Home Loan Banks. This action became effective on July 6, 1985. The Bank Board believes that this organizational change will improve the agency's operational effectiveness and enable

it to respond more quickly to the complex challenges posed by the thrift industry. As a result of this transfer no examination and assessment fees from savings and loan institutions were received by the Bank Board in calendar year 1986. In addition, \$3,124,895 of OES examinations-in-process accounts receivable and \$645,190 of furniture, fixtures, and equipment were transferred to the FHLBanks and therefore were charged against the Board's 1985 retained earnings.

On July 24, 1986, the Bank Board established a new Office of Regulatory Policy, Oversight, and Supervision as part of the Federal Home Loan Bank System. This organizational restructuring is a follow-up to the Board's delegation of field examination functions to the FHLBanks. It will enable the Board to exercise more efficient oversight and control of the examination/supervision functions. This action became effective September 27, 1986 and resulted in the abolishment of the Board's Office of Examinations and Supervision.

In addition both of these changes resulted in a corresponding decrease in personnel compensation, benefits and travel.

3. Retirement Plan - Substantially all of the Bank Board's employees are covered by the Civil Service Retirement System, which is currently two-tiered. For employees hired prior to January 1, 1984, the Bank Board withholds approximately 7 percent of their gross earnings. Their contribution is then matched by the Bank Board and the sum is transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits. For employees hired on or after January 1, 1984, the Bank Board withholds, in addition to social security withholdings, approximately 1.3 percent of their gross earnings, but matches such withholdings with a 7 percent contribution, as above. This second employee group will receive retirement benefits from the Civil Service Retirement System along with the Social Security System, to which they concurrently contribute. The retirement plan expenses incurred for calendar years 1986 and 1985 were \$1,025,131 and \$1,990,628 respectively.

Although the Bank Board funds a portion of pension benefits under the Civil Service Retirement System relating to its employees and makes the necessary payroll withholdings from them, the Bank Board does not account for the assets of the Civil Service Retirement System nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for the Retirement System and are not allocated to the individual employers. The Office of Personnel Management also accounts for all health and life insurance programs for retired federal employees.

4. Prior Year Adjustments - Prior year adjustments of \$99,237 represent adjustments to retained earnings for various receipts and expenses recorded in 1986 that should have been recorded in 1985. Since the effects of the prior year adjustments are not material, prior year's financial statements were not restated.

5. Refund of Construction Funds - In October 1985 the Federal Home Loan Banks were refunded the unused portion of the construction funds (\$489,771) they had originally contributed to build the Federal Home Loan Bank Board building in 1975. Therefore, paid-in-capital was reduced by \$489,771 since the FHLBank construction funds were originally credited to paid-in capital.

6. Capital:

	(in thousands)	
	1986	1985
Retained Earnings at Beginning of Year	\$ 8,306	\$ 9,965
Prior Year Adjustment (Note 4)	99	-0-
Adjusted Beginning Retained Earnings	8,405	9,965
Net Income	4,452	2,110
Transfer of FF&E (Note 2)	-0-	(645)
Transfer of OES Accounts Receivable (Note 2)	-0-	(3,124)
Retained Earnings at End of Year	<u>12,857</u>	<u>8,306</u>
Paid-in-Capital at Beginning of Year	44,094	44,584
Sale of Land (3rd and D Sts.) (Note 1)	(3,064)	-0-
Refund of Construction Funds (Note 5)	-0-	(490)
Paid-in-capital at End of Year	<u>41,030</u>	<u>44,094</u>
Total Capital at End of Year	\$ 53,887	\$52,400
	=====	=====

7. Litigation - At the end of 1986, 21 legal actions were pending that involved the Bank Board. Currently, it is not possible to predict the eventual outcome of the various actions. However, it is management's opinion that these claims will not result in liabilities to such an extent that they will materially affect the FHLBB's financial position.



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